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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY.	DOCKET NO. E-01345A-98-0473
IN THE MATTER OF THE FILING OF ARIZONA PUBLIC SERVICE COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 et seq.	DOCKET NO. E-010345A-97-0073
IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY.	DOCKET NO. E-01933A-98-0471
IN THE MATTER OF THE FILING OF TUCSON ELECTRIC POWER COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.A.C. R14-2-1601 et seq.	DOCKET NO. E-01933A-97-0772
IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. RE-00000C-94-0165

COMMENTS BY THE ARIZONA UTILITY INVESTORS ASSOCIATION ON THE PROPOSED SETTLEMENT AGREEMENTS WITH ARIZONA PUBLIC SERVICE COMPANY AND TUCSON ELECTRIC POWER COMPANY

Pursuant to Decision No. 61259 dated November 25, 1998, the Arizona Utility Investors Association (AUIA) hereby submits its comments with regard to the above-referenced settlement agreements for consideration by the Arizona Corporation Commission (the Commission).

I. Introduction

In response to Commission Decision No. 60977 dated June 22, 1998, Arizona Public Service Co. (APS) and Tucson Electric Power (TEP) filed their plans for stranded cost recovery on Aug. 21, 1998, Eleven weeks later, on Nov. 5, 1998, the Staff of the Commission announced that it had negotiated proposed settlement agreements with both APS and TEP and those agreements are the subject of the instant hearing scheduled to begin on December 3.

II. Time is of the Essence

Almost every participant in these proceedings -- including the signatories -- can find something to like and something to dislike in these settlement agreements. As we will discuss below, AUIA has serious concerns about the impact of some elements of the agreements on shareholder rights.

However, the most serious and immediate fiduciary threat is that these agreements might not be concluded by the end of 1998.

In pre-filed testimony, the Staff declared that one of its objectives is to resolve the issues contained in the settlement agreements prior to Jan. 1, 1999, so that electric competition may proceed on schedule. On the other hand, some intervenors have urged the Commission to delay these proceedings, arguing that competition can proceed without a resolution of stranded costs and the other issues contained in the settlements.

AUIA would like to reinforce the Staff's sense of urgency in the strongest terms possible.

The utilities have argued repeatedly that the Commission cannot legally alter their certificates of convenience and necessity without providing compensation for the damages they will suffer in the loss of their exclusive service franchises. AUIA agrees that this is the correct legal position.

It follows that each company should not relinquish any of its customers to competition unless there is a lawful order of the Commission in place which authorizes an equitable method for recovering stranded costs. To act otherwise would, in AUIA's view, place the officers and directors of the companies at legal risk for failing to perform their fiduciary duties.

While AUIA has specific reservations about the proposed agreements, we believe that no one's interest will be served by plunging the Arizona electric industry into a quagmire of litigation. Therefore, we urge the Commission to take action to resolve stranded cost and the other issues incident to it prior to Dec. 31, 1998.

III. The APS Agreement

Some issues which are of interest to AUIA are common to both the APS and TEP agreements. In such cases we will deal with them in the context of the APS agreement.

A. The Market Generation Credit Is Fair

In general, AUIA believes that the market generation credit (MGC) is an appropriate method for determining stranded cost recovery. By definition, stranded cost represents the difference between the utility's all-in cost of generation and the market price.

The method agreed upon by the Staff and the companies is nearly contemporaneous and it minimizes market speculation. Because the total amount of stranded cost that can be collected is tied to the market price, it is also self-policing.

Since the market price represents an average acquisition cost, there will always be energy supplies selling into the market below that price which assures that savings are available for those who are proficient in the competitive market.

B. The MGC Adders Are Unjustified and Discriminatory

There is no economic justification for the adders (also referred to as shopping credits) to the market generation credit in either of the CTC calculations. The adders are simply gratuities which will primarily benefit large users (collectively, the Big Dogs), especially in the first two years.

On the APS system, an average 3-mill adder amounts to an extra $65 million in savings above the MGC after the year 2000. At a market price of $26 per MWh, for example, the adder amounts to a 12% premium. Over the stranded cost recovery period, the adder could amount to $285 million or nearly as much as APS is likely to recover in stranded costs.

Previous comments indicate that the large users will demand a significant increase in the adder, reportedly to as much as 9 mills. Such an increase would raise the gratuity to $200 million annually over the MGC and would dwarf stranded cost recovery.

The adders also discriminate against standard offer customers who will continue to pay the same level of fixed costs in their rates that they do today except to the limited extent that they benefit from future rate reductions.

If the adder were increased, we doubt seriously that APS could a) recover stranded costs, b) provide four consecutive rate reductions and c) meet its ongoing financial obligations. Shareholders and small customers would share the pain of raising the ante for the Big Dogs.

TEP's circumstances certainly are different from APS, including the fact that its MGC calculation is an interim solution pending divestiture. However, we cannot find any justification for an adder higher than APS' and the discrimination against standard offer customers is even greater.

For all of the reasons we have cited, the Commission should reject any proposed increases in the adders.

C. Mandatory Rate Reductions Are Improper

Prospective ratemaking is just as improper as retroactive ratemaking. The Commission has no legal authority to require rate reductions in future years except, of course, that APS and TEP are agreeing to it.

Furthermore, after 2000, according to the Commission's rules governing competition, <u>all customers</u> will be eligible for the competitive market and the Commission has no business negotiating or mandating rates in the competitive market.

A continuing agreement to <u>share</u> net savings, as in APS' existing rate reduction agreement, might be appropriate, but a minimum rate reduction requirement places all of the risk on the utilities' shareholders.

AUIA has no reliable way to determine the combined effects of growth projections, mandated rate reductions and shopping credits on APS' net revenues through 2004. However, we suspect that the formula is vulnerable to economic decline and we are very concerned about mandating revenue reductions into the future.

On the assumption that the rate cuts are a political imperative, we submit that any proposed increase in the shopping credit should be a deal killer for APS.

D. Market Power Objections Are Baseless

AUIA totally rejects the Staff's premise that stranded cost recovery should be held hostage to market power considerations. No competent evidence of market power has been offered in these dockets.

Since APS and TEP have agreed to the proposed swap of assets, the Commission's policy of trying to separate generation from transmission becomes a harmless exercise in rearranging the furniture. On the other hand, the Attorney General (AG) and other intervenors who are brandishing the threat of increased market power are truly barking up the wrong tree.

At a minimum, it is counter-intuitive to suggest that reducing vertical market power increases some other kind of market power. But there is also a jurisdictional reality that makes this issue a red herring in this proceeding.

For example, if APS had decided independently to sell its transmission to TEP, it would be a matter for approval by the Federal Energy Regulatory Commission (FERC) and it is today. Neither the Commission nor the AG has hegemony over the transaction other than the standing they acquire at FERC. It is largely irrelevant that this Commission is on a mission to reduce perceived market power.

Likewise, if TEP decided independently to sell some generation to APS, the Commission's inquiry would be limited to the question of prudence as it relates to customer rates. In this instance, the APS purchase may affect TEP's stranded costs, but that doesn't give rise to an issue of market power, especially since the Commission's goal is to deregulate generation.

Unfortunately, the Commission invited a market power frenzy because it raised the issue to such prominence in the settlements. This genie probably won't go back into the bottle, but it can be ignored.

E. Loose Ends in the Asset Exchange

As a matter of first impression, the stranded cost portion of the APS settlement agreement is contingent on the exchange of assets which, in turn, is subject to the Memorandum of Understanding (MOU) and the completion of a Definitive Agreement between the two companies.

From an APS shareholder's point of view, this arrangement leaves some troubling loose ends.

First, the settlement agreement asserts that the asset trade will be subject to "independent appraisals and fairness opinions," but the MOU establishes that APS' transmission will be transferred at book value and TEP's generation will be sold at an already agreed upon price of $165 million as of Jan. 1, 2001.

AUIA believes the projected price of the generation is approximately 150% of book value and the sale will contribute to mitigating TEP's overall stranded costs.

This may be a suitable price and we will lay aside the question of whether Pinnacle West shareholders should have to mitigate TEP's stranded costs as the price of recovering their own stranded costs. But we seek assurance that the settlement agreement doesn't raise a due diligence expectation that isn't fulfilled in the MOU which could undermine the transaction at a later date.

Second, the MOU requires TEP to purchase 200 MW of power from APS during the years 2001 through 2004, However, one of the precedent conditions for closing the asset swap is that TEP will obtain an order from the ACC to recover in rates its costs under the Power Purchase Agreement.

It is unclear when TEP is to obtain such an order, but it is a disturbing prospect that two years from now the APS recovery plan could come unraveled because TEP was unable to get Commission approval to recover its purchased power costs.

That contingency should be foreclosed now as a part of the settlement agreements.

F. Solar Portfolio Coercion

AUIA has argued consistently in these dockets that the imposition of the solar portfolio standard is illegal, contradictory to the development of a free market in electricity and inimical to the interests of utility shareholders.

Requiring the companies to agree "to support the continuation of the Solar Portfolio Standard in future Commission proceedings" in a document that defines their financial future is simple extortion. The application of a "green" rate and the vague promise of deferred cost recovery are not sufficient to offset the unwarranted risk to investors.

IV. The TEP Agreement

We have already commented on several points that are common to the two settlement agreements and on some apparent loose ends that arise in the MOU between APS and TEP. Beyond those issues, our concern with the TEP agreement is that it is an unfinished arrangement, a work in process that is full of uncertainty for Unisource shareholders.

We are reminded of the old admonition that one should be careful what one wishes for because he might get it. The Commission asked for diversification and now it has it.

AUIA has consistently opposed diversification as a solution to stranded cost, in part because it is not necessarily a clean procedure or one that has a predictable result. In this instance, Unisource management has chosen diversification as its preferred option. Given the fact that Decision No. 60977 offers no other route to 100% recovery of stranded cost, we do not quarrel with management's decision.

However, we are troubled that once the Commission and TEP push the button on diversification, there will still be major hazards to negotiate that have uncertain outcomes.

Among these is the unresolved question of TEP's leveraged leases on some of its generating facilities and what it will cost to buy them out. In addition, there is the issue of the impact of two-county financing and the potential requirement to replace that financing or face retroactive tax consequences.

TEP's initial filing indicated that its total stranded cost exposure could vary by as much as $600 million, depending in large part on how these issues play out. AUIA believes that the net cost of removing these encumbrances is a legitimate basis for stranded cost recovery.

Our concern is that a two-year auction process will transfer the final approval of stranded cost recovery to a future Commission which may not view divestiture as an unmitigated good if it doesn't like the price tag.

Obviously, the risk of such uncertainty belongs to the company's shareholders. We can only suggest that the contingencies should be tied down as tightly as possible in the settlement agreement.

This concludes the comments of AUIA.

Respectfully submitted, this 30th day of November, 1998

Walter W. Meek, President

CERTIFICATE OF SERVICE

An original and ten copies
of the foregoing Application
to Intervene filed this 30th
day of November, 1998, with:

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Copies of the foregoing Application
to Intervene hand delivered this
30th day of November, 1998, to:

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Copies of the foregoing Application mailed or faxed
this 30th day of November, 1998, to all parties of
record in the above-referenced Dockets.

Walter W. Meek